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040110Z Feb 05

C O N F I D E N T I A L SECTION 01 OF 02 TAIPEI 000490

SIPDIS

DEPT FOR EAP/TC
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E.O. 12958: DECL: 02/03/2015

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SUBJECT: HIGH SPEED RAIL - EXPOSING PITFALLS OF BOT FINANCE

REF: 04 TAIPEI 2466

Classified By: AIT Director Douglas H. Paal, Reason 1.5 d

Summary

1. (SBU) Despite cost overruns and technical problems, Taiwan High-Speed Rail Corporation (THSRC) insists that Taiwan's first high-speed railway, which will run the length of Taiwan's west coast, will open on schedule in October 2005. However, financial problems continue to plague THSRC forcing it to seek an eleventh revision of its credit contract with a consortium of banks and to seek capital from Formosa Plastics Group. The success or failure of the THSRC is increasingly a political issue, and the project has exposed some of the hazards of the build-operate-transfer method Taiwan is using to finance public works projects. (End summary)

Minor Delays, Significant Cost Overruns

2. (SBU) Taiwan's high-speed rail is still on track to open more or less on time, but has experienced cost overruns that have caused serious financial problems for THSRC. Construction costs have exceeded estimates by at least NT\$ 20 billion (over USD 600 million), more than 5 percent of total costs. Technical problems have increased expenses. Lee Sheau-jin, THSRC's Chief Financial Officer, told AIT/T that major construction and laying tracks have not encountered major problems and are running close to schedule. However, the "core systems," which include power supply, signals and communications systems, have caused difficulties.

3. (C) Lee said that many of the problems are due to the fact that THSRC originally developed its bid with European contractors. However, in the end, THSRC wound up with Japanese firm Shinkansen as the primary contractor. Shinkansen's experience with the older Japanese high-speed rail has made it difficult for them to meet some of the European-based standards in the contract. For example, special provisions had to be made to ensure that the train seats were fire-resistant, a feature that Shinkansen had not provided before. Other modifications were required to address average temperatures higher in Taiwan than Japan. According to Lee, these problems were compounded by the fact that as the Japanese systems evolved over time, there was inadequate documentation of their standards and specifications.

4. (SBU) THSRC conducted the first test runs of the train January 27 on a limited portion of track. The tests were months behind the original schedule, and in a mid-January interview with the press, THSRC chairwoman Nita Ing implied that the train would not be ready to begin operations by the October 2005 target. However, subsequent statements from THSRC officials have walked back Ing's statement and confirmed that the train will start running on time. THSRC's Lee told us that THSRC will open October 31.

Struggling for Capital

5. (C) THSRC's financial problems are more troubling than the technical ones. As recently as early August 2004, the THSRC was seeking to raise more than NT\$ 27 billion in capital by the end of the year (reported reftel). In September, THSRC reached a new agreement with the syndicated banks that have supplied loans for the project. On September 30, 2004, they signed the tenth revision of the syndicated credit contract, which set the goal that the THSRC would raise NT\$ 7.5 billion by the end of 2004. THSRC was only able to raise NT\$ 1.5 billion resulting in technical default. Under the terms of the contract, THSRC has six months to correct the situation or revise the contract. Otherwise the government has the right to terminate the contract. According to THSRC's Lee, the firm is now working on an eleventh revision.

6. (SBU) In the meantime, the syndicated banks stopped providing additional credit to THSRC. Chiao Tong Bank is the lead bank in the syndicate. It's chairman Cheng Shen-chi,

told the press that the bank consortium would meet soon to consider whether or not to resume credit. THSRC CFO Lee told us that the THSRC shareholders would meet March 4 to discuss the situation.

17. (SBU) The five original shareholders of THSRC, Continental Engineering, Evergreen Group, Fubon Group, Teco Group, and Pacific Electric Wire and Cable, all appear reluctant to invest more funds in the project. Some media reports indicated that the five had failed to maintain 25 percent equity in THSRC as required by the original agreement with the Taiwan government. CFO Lee denied these reports and confirmed that the five firms had fulfilled their obligations. Nevertheless, according to press reports, no representatives from Evergreen, Fubon or Teco attended the ceremony that marked the first test run.

18. (U) Although THSRC refuses to confirm it, Wang Yung-ching, chairman of Taiwan's largest industrial conglomerate Formosa Plastics Group, told the media that THSRC's Ing had approached him about investing in the project. According to the reports, Wang also said that Taiwan President Chen Shui-bian had suggested that he should help THSRC solve its financial problems. Wang indicated that he would explore the possibilities.

Comment - Political Football, BOT Pitfalls

19. (C) As President Chen's apparent involvement indicates, the THSRC is increasingly a political issue. Some Pan-Blue politicians have been very vocal in their criticism of the handling of the project. CFO Lee blamed hostile press and politicians for many of THSRC's problems. The source of much of the controversy lies in the structure of the build-operate-transfer (BOT) agreement with the Taiwan government. The government in effect guarantees the entire project. If for any reason, THSRC fails to complete construction the government must buy back the THSRC for up to NT\$ 325.9 billion. Although the agreement was signed with the KMT government in 1997, the perceived success or failure of the project will fall on the current DPP administration. In addition, some observers accuse THSRC of unfair practices for assigning an unduly large share of the subcontracts to the major shareholders or firms connected to the shareholders. Continental Engineering, in particular, has been singled out for criticism. The current situation exposes some of the pitfalls of Taiwan's BOT model. If Taiwan wants to use BOT contracts for major projects in the future, it must learn from the lessons of the THSRC. (End comment)

PAAL